

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, CA 94105

File No. RH01018047
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FINAL STATEMENT OF REASONS

INTRODUCTION AND UPDATED INFORMATIVE DIGEST

California Insurance Commissioner John Garamendi (“Commissioner”) has determined that he will amend the provisions of Title 10, California Code of Regulations, Chapter 5, Subchapter 9, Article 2, and Sections 2698.30 to 2698.42 and adopt subsection 2698.43. The purpose of the proposed regulations is to implement, interpret, and make specific the provisions of California Insurance Code Sections 1875.20-24. The Insurance Commissioner has determined that insurance fraud in the State of California is extensive. Hardly a victimless crime, insurance fraud is often organized crime. The increase in insurance fraud, particularly during the early 1990's led many to regard insurance fraud as the crime of the 90's.

→ According to the National Insurance Crime Bureau, the average American household pays an additional \$300 in auto insurance premiums per year to make up for automobile insurance fraud.

→ According to the RAND Corporation's Institute for Civil Justice, nearly two-thirds of the auto injury medical claims by Californians are exaggerated at best and fraudulent at worst, resulting in as much as \$3.5 billion a year in additional insurance premiums

As the National Council on Compensation Insurance (NCCI) and the California Commission on Health and Safety and Workers' Compensation indicate, there are many opinions about the size of the workers' compensation fraud problem.

→ The California Farm Bureau Federation stated although experts are unsure about the amount of fraud in the California workers' compensation insurance system, they think it's probably about \$1 billion to \$5 billion.

→ The California Little Hoover Commission concluded in 1993 that 30% of system costs, or \$3 billion, are wasted in fraud. It also stated that 20% to 30% of employee claims are fraudulent and businesses are twice more likely to commit fraud than an injured worker.

- The National Insurance Crime Bureau estimated in the year of 2000 that workers' compensation insurance fraud is the fastest-growing insurance scam in the nation, costing the industry \$5 billion per year by what many people consider a victimless crime.

Several reasons for new growth in this criminal insurance fraud arena were:

- Inflate claims by medical and/or legal mills,
- Public acceptance of insurance fraud,
- Increasing opportunities for fraud,
- Lack of adequate resources, such as manpower and funding, to investigate insurance fraud cases.

These costs of insurance fraud are borne both directly by the individual policyholder and indirectly by the consumer as the costs of goods and services increase to accommodate the higher premiums paid by businesses.

Initially, California law addressed the issue of deterrence and detection of such insurance fraud through a statutory scheme. California Insurance Code Section 1875.20 requires that every insurer admitted to do business in the state shall maintain a unit or division to investigate possible fraudulent claims; these units are referred to as Special Investigative Units or alternatively, SIU's. In 1994, the Insurance Commissioner promulgated regulations to implement the provisions of California Insurance Code Sections 1875.20-23 the originally promulgated regulations (found at California Code of Regulations, Title 10, Chapter 5, Subchapter 9, and Subsection 2698.40-42) governed the establishment, maintenance and oversight of Special Investigative Units. These (original) regulations were filed with the Secretary of State on May 3, 1994.

After the enactment of the original regulations the California Department of Insurance, Fraud Division implemented a plan to examine the activities of the Special Investigative Units and determine if insurance carriers had complied with all provisions of the regulations. This oversight activity revealed that the regulations were flawed, contained vague and ambiguous language and failed to provide specific guidance to insurance carriers that would enable them to implement the regulations and statutes. Accordingly, the Insurance Commissioner promulgated amendments to the regulations in the form of emergency regulations to address the deficiencies and provide needed specificity to the regulations then in place. These emergency regulations found at [California Code of Regulations Title 10, Subchapter 9, Article 2698.30 et. seq.] provided for specified staffing levels for the SIU's, a uniform standard for insurers to utilize in determining when to refer suspected fraud to the Department and specific content requirements and procedures for the referral of suspected fraud to the Fraud Division or other authorized governmental agencies required by statute and sanctions for the failure to comply with these regulations.

The emergency regulations became effective immediately and enhanced the insurer's ability to detect and deter fraud, so that California consumers would not have to continue to absorb the exorbitant costs of insurance fraud while permanent regulations were being developed. The Commissioner began the permanent rulemaking process and on September 1, 2004 issued a Notice of Hearing to initiate formal rulemaking proceedings.

On September 20, 2004 the California Legislature enacted California Insurance Code Section 1875.24; this statutory section became effective January 1, 2005. This statute established monetary penalties for violations of the proposed regulations in specified amounts based on whether the violation was willful or inadvertent and specifically granted the Commissioner the discretion to determine what constitutes an act for the purposes of imposing penalties. Further, this statute mandated that the Commissioner adopt regulations to implement California Insurance Code Section 1875.24 in accordance with the rulemaking provisions of the Administrative Procedures Act.

On November 10, 2004, the Commissioner held a public hearing regarding the proposed regulations. The Commissioner fully considered the oral testimony given at this hearing, the written public comments submitted by interested persons pursuant to the September 1, 2004 Notice of Hearing, as well as the new statutory requirement for regulations imposed by California Insurance Code Section 1875.24 and on March 18, 2005 issued revisions to the text in a document entitled "Revised Text." The Commissioner also issued a Notice soliciting written public comments on the revisions contained in the Revised Text as required by the Administrative Procedures Act. Following the close of the comment period and based on both the written comments submitted and Commissioner's own motion, the Commissioner further revised the text of the proposed regulations and issued a Second Notice of Revised Text and Revised Text dated June 9, 2005.

During the promulgation process of these regulations, the Commissioner received extensive comment on certain provisions of the proposed regulations. A significant amount of comment was received by the Commissioner on the following issues:

- 1) the definitions of act, willful and inadvertent;
- 2) the definition of integral anti-fraud personnel;
- 3) appropriate training requirements applicable to insurance company employees, special investigative unit personnel and integral anti-fraud personnel;
- 4) the appropriate legal standard and procedures for referral of suspected insurance fraud to the Fraud Division; and,
- 5) the appropriate legal procedures to be used when the Insurance Commissioner seeks documents from insurers regarding suspected insurance fraud.

After the close of the third comment period (June 9, 2005 - June 27, 2005) and based on all the written and oral comments received by the Commissioner and upon his own motion, the Commissioner has determined that no further revision to the text of these regulations is required.

THE SPECIFIC PURPOSE AND NECESSITY OF EACH SUBDIVISION

California Insurance Code Section 1875.20 requires that every insurer admitted to do business in the state shall maintain a unit or division to investigate possible fraudulent claims; these units are referred to as Special Investigative Units, or alternatively, SIU's. Section 1875.21 states that insurers may maintain the SIU using its own employees or by contracting with others for that purpose. Under Section 1875.23, expenses incurred in creating a distinct unit, hiring new employees, or contracting with another entity to fulfill the SIU requirements is included as an administrative expense for rate setting purposes. Newly enacted California Insurance Code Section 1875.24 provides a complete administrative scheme specifically for the determination and imposition of penalties for violations of the proposed regulations.

The specific purpose of each proposed adoption, and the rationale for the determination that each adoption is reasonably necessary to carry out the purpose for which it is proposed, together with a description of the public problem, administrative requirement, or other condition or circumstance that each adoption is intended to address, is set forth below.

Proposed Section 2698.30 (a)

Proposed Section 2698.30 (a) was adopted by the Insurance Commissioner in the March 18, 2005 Revised Text. This newly adopted subsection sets forth a definition of the term "act" for use specifically with California Insurance Code Section 1875.24.(b). California Insurance Code Section 1875.24 (b) sets forth various penalties for the violation of an act; however, no definition of the term "act" is set forth in the statute. Instead, 1875.24(b) provides that the Insurance Commissioner may determine what constitutes an act. Accordingly, the Commissioner has set forth the following definition to implement the provisions of 1875.24: "Act means any violation of the California Code of Regulations, Title 10, Chapter 5, Section 2698 30.-42, inclusive." This definition will be updated to include subdivision 2698.43 prior to filing with the Secretary of State.

Proposed Section 2698.30(b)

(Previously designated as Section 2698.30(a))

Proposed Section 2698.30(b) sets forth a definition of "authorized governmental agency" by referencing the Insurance Frauds Prevention Act ("IFPA"). Although this definition was not part of the emergency regulations, its inclusion is necessary to specify a term that is defined in different ways in the Insurance Code. The IFPA's use of the term "authorized governmental agency" is contextual in that it depends on the subject of the article in which it is used and defined. In Article 4, which applies to motor vehicle insurance fraud, the definition encompasses the Department of the California Highway Patrol, The Department of Insurance, the Department of Justice, the Department of Motor Vehicles, the police department of a city, or a city and county, the sheriff's office or department of a county, a law enforcement agency of the federal government, the district attorney of any county, or city and county, and any licensing agency governed by

the Business and Professions Code. In Article 5, which applies to arson investigations, “authorized agency” includes the State Fire Marshal, the Director of the Department of Forestry and Fire Protection, the chief of any city or county fire department, the chief of any fire protection district, the Attorney General, any district attorney, or any peace officer, the Department of Insurance, and any federal agency. Article 7, workers’ compensation insurance fraud reporting, defines “authorized governmental agency” as the district attorney of any county, the office of the Attorney General, the Department of Insurance, the Department of Industrial Relations, the Employment and Development Department and any licensing agency governed by the Business and Professions Code. As such, there is not single definition of “authorized governmental agency.” The proposed regulations use the term, but do not delineate its different meanings. The IFPA, as a whole, delineates its different meanings depending on the type of insurance in which it is used. Therefore, by referencing the IFPA, the proposed regulations provide a clear definition of the term regardless of the type of insurance to which the proposed regulations are applied. The Commissioner believes this is a clear definition of a term that has different meanings. This definition informs insurers what the term means regardless of its context. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(c)

(Previously designated as Proposed Section 2698.30 b)

Proposed Section 2698.30(c) sets forth the definition of “claims handler” used in these regulations. This definition provides clarity to the term so insurers will know which employees are encompassed by the regulations’ use of the word. Section 2698.30 uses the term “claim handlers” in its definition of “integral anti-fraud” personnel. This section ensures that interested parties will have a clear understanding of both terms. The Commissioner believes that this is a clear definition that accurately reflects the use of the word within the insurance industry. This section implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.30(d)

(Previously designated as proposed Section 2695.30(c))

Proposed Section 2698.30(d) defines “Commissioner” as the Insurance Commissioner of the State of California. This definition makes specific a term used throughout the regulations. This section implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.30 (e)

(Previously designated as proposed Section 2695.30(d))

Proposed Section 2698.30(e) defines “Communication” as including the referral of suspected insurance fraud to the Department of Insurance and providing information and documents requested by the Fraud Division. The Commissioner has determined that this definition adequately covers those communications that are necessary. This section

implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.30(f)

(Previously designated as proposed Section 2695.30(e))

Proposed Section 2698.30(f) specifies that “Department” means the California Department of Insurance. The term is used throughout the regulations but the IFPA also references governmental departments other than the Department of Insurance. This definition avoids confusion as to which department the term refers. This section implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.30(g)

(Previously designated as proposed Section 2695.30(f))

Proposed Section 2698.30(g) clarifies that “Fraud Division” refers to the California Department of Insurance Fraud Division formerly known as the Bureau of Fraudulent Claims. The Bureau of Fraudulent Claims was designated the Fraud Division subsequent to the publication of California Insurance Code Sections 1875.20 et seq. on October 1, 1992. This definition clarifies that “Fraud Division” has the same meaning as “Bureau of Fraudulent Claims” as used throughout the IFPA. This definition is necessary to provide notice of the name change in order to create continuity between the proposed regulations and the IFPA. This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24.

Proposed Section 2698.30(h)

Proposed Section 2698.30 (h) was adopted by the Insurance Commissioner in the March 18, 2005 Revised Text. This newly adopted subsection sets forth a definition of the term “hearing” for use specifically with California Insurance Code Section 1875.24(d). California Insurance Code Section 1875.24 (c) provides several courses of action that an insurer may take if served with a notice of noncompliance. California Insurance Code Section 1875.24 (c)(2) provides that an insurer may request a hearing; however, no definition of the term “hearing” is set forth in the statute. Accordingly, the Commissioner has gone forward and defined “hearing” as an adjudicative proceeding initiated by the Insurance Commissioner pursuant to the provisions California Insurance Code 1875.24(d). This definition was adopted by the Insurance Commissioner in the March 18, 2005 Revised Text. This newly adopted subsection sets forth a definition of the term “hearing” so it can be understood by the regulated entities. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(i)

Proposed Section 2698.30 (i) was adopted by the Insurance Commissioner in the March 18, 2005 revised text. This newly adopted subsection sets forth a definition of the term

“inadvertent” for use specifically with California Insurance Code Section 1875.24(b). California Insurance Code Section 1875.24(b) provides that “when violations relative to the maintenance and operation of a unit are inadvertent the violations shall be considered a single act for the purposes of this section. No definition of “inadvertent” is provided by the enabling statutes. Accordingly, the Commissioner set forth the following definition in the March 18, 2005 revised text: “inadvertent means unintentional and outside the control of the insurer”. This section was further revised in the June 9, 2005 revised text in response to comments received from the insurers that the language “outside the control of the insurer” was too high a standard to impose as it was so difficult to meet that it would render all acts to be willful. The Commissioner accepted these comments and revised the proposed definition of “inadvertent” so that the words “outside the control of the insurer” were deleted.

Proposed Section 2698.30(j)(1)

(Previously designated as proposed Section 2698.30(i))(1)

California Insurance Code Section 1875.20 requires that every insurer maintain a fraudulent claims investigation unit (also known as SIU). The Commissioner believes that reinsurance is a sufficiently distinct type of insurance that is more properly considered in a separate rulemaking, should the Commissioner determine in the future that such regulations are necessary. Therefore, proposed Section 2698.30(j)(1) defines the scope of “insurer” to exclude reinsurers. Without this definition, reinsurers might assume that they fall within the scope of the term and thus the regulations.

This specification is also necessary to avoid confusion with the definitions in Sections 1872.2, 1874.1, 1875 and 1877.1 of the IFPA. The definition in this proposed section has been tailored for these regulations and no other definition should apply. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(j)(2)

(Previously designated as proposed Section 2698.30(i))(2)

California Insurance Code Section 1875.20 requires that every insurer maintain a fraudulent claims investigation unit. California Insurance Code Section 12400.1 states that title insurance is not subject to Sections 1875.20-23. Therefore, proposed Section 2698.30(j)(2) defines the scope of “insurer” to exclude title insurers. Without this definition, title insurers might assume that they fall within the scope of the term and thus the regulations.

This definition is also necessary to avoid confusion with the definitions in Sections 1872.2, 1874.1, 1875 and 1877.1 of the IFPA. The definition in this proposed section has been tailored for these regulations and no other definition should apply. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30 (j)(3)

(Previously designated as proposed Section 2698.30(i))(3)

California Insurance Code Section 1875.20 requires that every insurer maintain a fraudulent claims investigation unit. The Insurance Code exempts fraternal fire insurers from these regulations in Sections 9080 and 9080.1. Therefore, proposed Section 2698.30(g)(3) defines the scope of “insurer” to exclude fraternal fire insurers. Without this definition, fraternal fire insurers might assume that they fall within the scope of the term and thus the regulations. This section is necessary to comply with Sections 9080 and 9080.1.

This definition is also necessary to avoid confusion with the definitions in Sections 1872.2, 1874.1, 1875 and 1877.1 of the IFPA. The definition in this proposed section has been tailored for these regulations and no other definition should apply. This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24

Proposed Section 2698.30(j)(4)

Previously designated as proposed Section 2698.30(i)(4)

California Insurance Code Section 1875.20 requires that every insurer maintain a fraudulent claims investigation unit. The Insurance Code exempts fraternal benefit societies from these regulations in Section 10970. Therefore, proposed Section 2698.30(j)(4) defines the scope of “insurer” to exclude fraternal benefit societies. Without this definition, fraternal benefit societies might assume that they fall within the scope of the term and thus the regulations. This section is necessary to comply with Section 10970.

This specification is also necessary to avoid confusion with the definitions in Sections 1872.2, 1874.1, 1875 and 1877.1 of the IFPA. The definition in this proposed section has been tailored for these regulations and no other definition should apply. This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24.

Proposed Section 2698.30(j)(5)

Previously designated as proposed Section 2698.30(i)(5).

California Insurance Code Section 1875.20 requires that every insurer maintain a fraudulent claims investigation unit. The Insurance Code exempts firemen, policemen, or peace officer benefit and relief associations from these regulations in Section 11400. Therefore, proposed Section 2698.30(g)(5) defines the scope of “insurer” to exclude firemen, policemen, or peace officer benefit and relief associations. Without this definition, these associations might assume that they fall within the scope of the term and thus the regulations. This section is necessary to comply with Section 11400.

This definition is also necessary to avoid confusion with the definitions in Sections 1872.2, 1874.1, 1875 and 1877.1 of the IFPA. The definition in this proposed section has been tailored for these regulations and no other definition should apply. This section

implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(j)(6)

Previously designated as proposed Section 2698.30(i)(6)

California Insurance Code Section 1875.20 requires that every insurer maintain a fraudulent claims investigation unit. The Insurance Code exempts grant and annuity societies from these regulations in Section 11524. Therefore, proposed Section 2698.30(j)(6) defines the scope of “insurer” to exclude grant and annuity societies. Without this definition, grant and annuity societies might assume that they fall within the scope of the term and thus the regulations. This provision is necessary for compliance with Section 11524.

This specification is also necessary to avoid confusion with the definitions in Sections 1872.2, 1874.1, 1875 and 1877.1 of the IFPA. The definition in this proposed section has been tailored for these regulations and no other definition should apply. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(j)(7)

California Insurance Code Section 1875.20 requires that every insurer maintain a fraudulent claims investigation unit. California Insurance Code Section 12742 only permits those sections of the Insurance Code listed in Section 12743 to apply to home protection. Sections 1875.20-24 do not appear in Section 12743 and thus home protection is exempt from these regulations. Therefore, proposed Section 2698.30(g)(7) defines the scope of insurer to exclude home protection. Without this definition, relevant parties might assume that home protection falls within the scope of the term and thus the regulations.

This definition is also necessary to avoid confusion with the definitions in Sections 1872.2, 1874.1, 1875 and 1877.1 of the IFPA. The definition in this proposed section has been tailored for these regulations and no other definition should apply. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(k)

Previously designated as proposed Section 2698.30(j)

Proposed Section 2698.30(k) sets forth a definition of the term “integral anti-fraud personnel” used in these regulations. This definition is necessary to identify one of the on-going responsibilities of an insurer for compliance with these regulations. The emergency regulations required the SIU to train integral anti-fraud personnel at Section

2698.43(a), but did not define the group. The identification of this group will improve the effectiveness of these regulations.

This definition includes personnel who the insurer has not identified as being directly assigned to its SIU, but whose duties may include the processing, investigation, or litigation pertaining to payment or denial of a claim or application. The section provides examples of employees that fall within this definition. “Integral anti-fraud personnel” have certain responsibilities required by the regulations. These responsibilities continue even if an insurer contracts with another entity to maintain its SIU. Without this definition, the term would be ambiguous and employers would not know to whom to apply the regulations. This definition provides insurers with clear guidelines on determining which of their employees may be considered “integral anti-fraud personnel.”

The inclusion of personnel not directly assigned to the SIU is necessary because the SIU has additional obligations under the regulations independent from the obligations of other insurer employees. Effective implementation of these regulations requires that the SIU and other insurer employees shall understand how to cooperate with each other. Claims handlers are part of an insurer’s normal staff and are part of integral anti-fraud personnel because their close relationship with claims puts them in the best position to make an initial determination of suspected fraud. The naming of integral anti-fraud personnel identifies those employees who will be handling claims and applications and thus forward cases of suspected insurance fraud to the SIU. Identification of these persons is necessary for adequate training for their responsibilities pursuant to these regulations. These regulations will be ineffective if anti-fraud personnel are not properly identified and well-trained.

The proposed section deletes the words “receipt” and “agents” from the emergency regulations. These changes more closely reflect the actual practices of insurance carriers. The deletion of the word “receipt” reflects the fact that the receipt of a claim or application is commonly a clerical function that does not involve any analysis of a claim or application. Hence, this action would not be the best place for the detection of suspected insurance fraud. The Commissioner has also deleted the word “agents” as he recognizes that its inclusion may result in the section having too broad of a scope. Agents may include soliciting agents, general agents, or independent agents. Inclusion of agents within the definition may subject agents to duplicative or unduly burdensome training requirements as the California Insurance Code and California requires insurance agents to complete pre -licensing courses that contain fraud components.

This section as proposed contains the words “within the claims functions” after the words “call center staff.” The Commissioner has added language to reflect that not all call center staff will be in the position to detect fraud; only the call center staff acting within the claims function will have the appropriate contact with claims and applications that enable them to detect suspected insurance fraud. This change is necessary for the purposes of clarity and will ensure a precise definition of the term “integral anti-fraud personnel.” Further, the Commissioner has specifically drafted this section so that the definition focuses on the functions performed by the employee and not simply their title

or classification. The emphasis on function is necessary to ensure an adequate definition of those persons that do require training.

This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24.

Proposed Section 2698.30(l)

Previously designated as proposed Section 2698.30(k)

An essential component of the Insurance Frauds Prevention Act is that it requires and/or provides that insurers and others refer information concerning incidents of suspected insurance fraud to the Department for review and investigation. However, in contrast to the uniform intent of the IFPA, the language in the various sections describing when this referral process should or may be undertaken varies depending on the section of the code and type of insurance. For example, in CIC section 1872.4 uses the term “believes” CIC section 1874.2, relating to auto insurance and CIC 1877.3, concerning workers’ compensation, use the phrase “reason to believe,” CIC section 1875.2, concerning arson investigations, uses the phrase “has reason to suspect”, and CIC section 1879.5, providing a general authorization to report, merely uses the term “believes.” This apparent lack of a uniform standard for referring incidents of suspected fraud was a central theme and source of concern and confusion and even cited as a cause for reticence to make referrals by the participants during the pre-notice public workshops. This apparent lack of an express standard for referral has also resulted in the Department encountering difficulties in its ability to audit insurers compliance with the applicable statute and existing regulations. This definition will provide a clear and uniform standard to be applied by insurers and others to determine when an incident of suspected fraud must and/or may be reported to the Department.

This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24.

Proposed Section 2698.30(m)

Previously designated as proposed Section 2698.30(l)

Proposed Section 2698.30(m) defines “red flag” or “red flag event” as facts, circumstances, or events that support an inference of fraud. These terms appear throughout the regulations, often in connection with training for awareness of “red flags” or for the documentation of “red flag” procedure. This definition provides a clear definition for insurers to understand what is required of them when the regulations refer to “red flags” or “red flag events.” This definition reflects an understanding of the term that can be readily understood and applied by the regulated entities.

This definition is also consistent with the objective standard set by Section 2698.30(l) because they are inferences based upon facts. This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24.

Proposed Section 2698.30(n)

Previously designated as proposed Section 2698.30(m)

Proposed Section 2698.30(n) clarifies that “regulations” means California Code of regulations, Title 10, Chapter 5, Subchapter 9, Article 2. The term “regulations” is used throughout the regulations and this definition specifies that the term does not refer to any other regulations, unless otherwise noted. This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24.

Proposed Section 2698.30(o)

Previously designated as proposed Section 2698.30(n)

California Insurance Code Section 1875.20 requires that every insurer admitted to do business in this state maintains a fraudulent claims investigation unit. Proposed Section 2698.30(n) defines “Special Investigative Unit” as the fraudulent claims investigation unit referenced in Section 1875.20. Pursuant to California Insurance Code Section 1875.21, this definition allows for an insurer to maintain the SIU by using its own employees or by contracting with another entity. This definition makes clear that the SIU is the division necessary for compliance with applicable sections of the IFPA for direct responsibility for performing the functions and activities as set forth in these regulations. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(p)

Proposed Section 2698.30(p) defines the scope of “suspected insurance fraud” so that the term does not encompass all suspicion. This definition is necessary in that it provides with an objective standard that can be consistently applied. The regulations refer to “suspected insurance fraud” in the context of referrals. Insurers will be able to use this definition to determine what constitutes “suspected insurance fraud” (including claims as well as application fraud) for referral purposes.

This definition is also necessary to be consistent with the objective standards in Sections 2698(l.) This is true because a lower standard would require less for a referral. Insurers would refer information upon the slightest suspicion or intuition in order to ensure compliance. This section implements, interprets, and makes specific California Insurance Code Section 1857.20-24.

This section has been changed from the emergency regulations by adding the words “or omission of fact” after the words “misrepresentation of fact.” This change does not add any burden to insurers but merely reflects that an omission of fact can potentially be equally as indicative of fraud as a misrepresentation of fact.

Proposed Section 2698.30(q)

Previously designated as proposed Section 2698.30(p)

Proposed Section 2698.30(q) clarifies that “The Insurance Frauds Prevention Act” refers to California Insurance Code Section 1871-1879.8. This definition is necessary to provide notice of the Act’s equivalency in meaning with that particular code section and to provide notice of the Act’s location. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.30(r)

Proposed Section 2698.30 (r) was adopted by the Insurance Commissioner in the March 18, 2005 revised text. This newly adopted subsection sets forth a definition of the term “willful” for use specifically with California Insurance Code Section 1875.24(b). California Insurance Code Section 1875.24 (b) sets forth penalties for the “willful violation of an act; however, no definition of the term “willful” is set forth in the statute. Accordingly, the Commissioner set forth the following definition of the term in the March 18, 2005 Revised Text in subsection (r), so that the term could be readily understood and easy to comply with. The originally proposed definition provided:

“Willful” means a purpose or willingness to commit the act or omission referred to in the California Insurance Code or in these regulations. It does not require intent to violate the law or to injure another.”

Based on comments received the Commissioner further revised the definition to delete the final sentence and to add the following language: “The Commissioner shall use the factors set forth at California Code of Regulations Section 2591.3(d)(1)(A-E) to determine whether or not an act is willful. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.31

California Insurance Code Section 1875.20 requires that every insurer admitted to do business in this state shall maintain a fraudulent claims investigation unit. Proposed Section 2698.31 implements and makes specific this obligation by requiring compliance with the applicable sections of the IFPA and these regulations regarding the establishment, operation and continuous existence of an SIU. The purpose of this provision is to clarify that an insurer will continue to have responsibilities even if it contracts with another entity to maintain its SIU. Numerous obligations remain for the insurer even after contracting with another entity to maintain its SIU. For example, insurers must still file an annual report with the Department. This section is necessary to clarify that these regulations are implementing, interpreting, and making specific California Insurance Code Sections 1857.20-24.

Proposed Section 2698.32(a)

Proposed Section 2698.32(a) sets guidelines for adequately staffing a SIU. Article 5.6 of the IFPA requires the creation of a fraud investigation unit, but does not specify how an insurer may know when its investigation unit is adequate or even what factors to look at to make this determination. Section 2698.32(a) states that adequacy is determined by its demonstrated ability to establish, operate and maintain an SIU that is in compliance with these regulations. This section adds needed specificity to the emergency regulations by listing factors that may be considered in staffing the SIU.

These factors are included because of their relation to the amount of suspected insurance fraud that can reasonably be expected by an insurer. Adequacy of staffing depends on whether the SIU can handle the number of claims of suspected insurance fraud in a thorough manner that will detect and deter fraud. This subsection is necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.32(b)

Article 5.6 of the IFPA requires the creation of a fraud investigation unit, but does not specify what type of knowledge is required of the staff to perform their function. Section 2698.32(b) is necessary because it provides insurers with a clear list of subjects, analyses, and patterns they should be familiar with as well as capabilities they should have in order to perform the functions required by these regulations. This subsection focused on knowledge requirements and did not allow insurers to consider the actual experience of an individual to determine if they had sufficient knowledge. This subsection was amended to provide as follows: “An SIU shall be composed of employees who have knowledge and/or experience.” This subsection is necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.33(a)

California Insurance Code Section 1875.21 provides that an insurer may “maintain the [SIU] using its own employees or by contracting with others for that purpose.” Section 1875.21 does not provide guidelines, however, for how insurers may contract with others for the purpose of following these regulations and their obligations thereafter. Section 2698.33(a) clarifies that such a contract does not relieve the insurer of any obligation under these regulations or the IFPA.

Numerous obligations continue despite the existence of a contract to maintain a SIU. For example, Section 2698.44, of the emergency regulations, requires an insurer to oversee the SIU’s operations. Without this clarification, some insurers may mistakenly believe that they no longer have a duty to fulfill such obligations after another entity contracts to maintain their SIU.

The Commissioner has determined that it is in the best interests of consumers that insurers continue to participate in the anti-fraud process because they are often in the best

position to detect fraud. For example, insurers' integral anti-fraud personnel must still communicate with the SIU in order to comply with these regulations even after another entity contracts for the maintenance of the SIU. This is because claim handlers are in the best position to initially detect fraud. If these insurer employees had no obligation to cooperate with these regulations and the SIU then the SIU's investigation would be significantly more difficult. This subsection is necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.33(b)

Proposed Section 2698.33(b) requires an insurer to provide the Department with a copy of any agreement with another party to create a SIU. This section is necessary for the effective administration of these regulations because previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. Despite the creation of a contract with another entity, an insurer remains accountable to the Department as well as consumers to fulfill the obligations of these regulations. Only then may insurance fraud be adequately detected and deterred. Providing a copy of such agreements to the Department assures that an insurer's responsibilities under these regulations will be carried out and that insurance fraud is adequately being detected and investigated. This section is necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.33(c)(1)

California Insurance Code Section 1875.21 allows for an insurer to contract with another entity for purposes of maintaining a SIU. Section 1875.21, however, is silent as to what terms such a contract must include. Proposed Section 2698.33(c)(1) makes specific Section 1875.21 by requiring that all duties and functions of the parties be listed as well as an explanation of how the insurer will monitor the performance of the contract responsibilities.

This section clarifies that an insurer's obligations also include the parties' functions pursuant to the terms of their contract. This section is thus necessary to inform the contracting parties as well as the Department as to who is obligated to perform which functions pursuant to these regulations. Without this section, the contracting parties might not have a clear understanding of their duties and there would be little accountability.

The insurer shall choose the manner in which the contract is monitored because it is a contextual decision based on terms of the parties' agreement. This subsection is necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.33(c)(2)

California Insurance Code Section 1875.21 allows for an insurer to contract with another entity for purposes of maintaining a SIU. Section 1875.21, however, is silent as to what

terms such a contract may not include. Proposed Section 2698.33(c)(2) makes specific Section 1875.21 by prohibiting the inclusion of provisions that could provide disincentives to the referral and/or investigation of suspected insurance fraud.

This section is necessary to ensure compliance with these regulations and their purposes. Allowances for breach of duty under the SIU contract, for example, could discourage the reporting of suspected fraud. There are an innumerable number of theoretical provisions that could contravene the purposes of these regulations by inhibiting the flow of information regarding fraud and thus have a detrimental effect on this State's economy. Without this section, a contractual SIU would be held to a lesser standard than an internal SIU because an SIU contract could include disincentives to comply with the purposes of these regulations. This subsection is thus necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.33(c)(3)

California Insurance Code Section 1875.21 allows for an insurer to contract with another entity for purposes of maintaining a SIU. Section 1875.21, however, is silent as to what terms such a contract must include. Proposed Section 2698.33(c)(3) makes specific Section 1875.21 by prohibiting the inclusion of provisions that purport to relieve an insurer of any obligation to comply with the requirements of these regulations and the IFPA. This section is necessary to maintain insurer compliance with these regulations because some provisions of these regulations apply to an insurer despite the existence of a contract. For example, an insurer must establish training for its integral anti-fraud personnel so they know how to communicate with the SIU and the Department. The Commissioner has determined that in order to effectively pursue the purposes of the IFPA and these regulations, an insurer must remain accountable for fraudulent activity within its business even if it contracts with another entity for the purpose of maintaining a SIU. Without this section, the contracting parties might not have a clear understanding of their duties pursuant to these regulations and the prevention of fraud would be burdened. This subsection is necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.33(c)(4)

California Insurance Code Section 1875.21 allows for an insurer to contract with another entity for purposes of maintaining a SIU. Section 1875.21, however, is silent as to what terms such a contract must include. The lack of such a provision could allow for a lower standard for a contractual SIU than for an internal SIU. Proposed Section 2698.33(c)(4) makes specific Section 1875.21 by requiring all such contracts to include a provision that requires the contracted entity to comply with all applicable provisions of the IFPA and these regulations. This section is necessary because an insurer remains obligated to comply with these regulations and may not contravene these responsibilities by contracting with a party who will not comply. By requiring the inclusion of this provision, a contracting entity is bound to comply with these regulations in the way that

an insurer must. A contractual SIU must have the same obligations that an internal SIU has for these regulations to successfully detect and deter insurance fraud uniformly within the State of California. This subsection is necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.34(a)

The immediate implementation of these regulations is necessary to stop the effect of fraud on this State's economy. This urgency requires that insurers communicate with the Department and authorized governmental agencies pursuant to the IFPA in order to insure that compliance and progress are effectuated. Proposed Section 2698.34(a) makes specific California Insurance Code Sections 1875.20-23 and clarifies the emergency regulations by requiring this type of communication by insurers and any entity performing SIU functions. Without this section, insurers might have the mistaken belief that communication required by other portions of the IFPA is inapplicable to Article 5.6. This is not the case because the IFPA, California Insurance Code Section 1871 et seq., is applicable to a SIU. Specifically, Sections 1872.3, 1872.4, 1873, 1874.2, 1874.4, 1875.4, 1877.1, 1877.3, 1877.4, 1877.5 1879.5 provide statutory guidelines for communication with the Department and other authorized governmental agencies. Thus this section is necessary to ensure that adequate communication, as required by the Insurance Code, exists between insurers and authorized governmental agencies. Such communication is necessary to implement, interpret, and make specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.34(b)(1)-(10)

Proposed Section 2698.34(b)(1)-(10) sets forth an non-exclusive list of the types of documents that an insurer may reasonably expect the Department or other authorized governmental agency to deem important and thus necessary to be delivered upon request. This section clarifies that insurers can expect their obligations to include the prompt delivery of certain documents. The delivery of relevant documents deemed important is necessary to the effective supervision and the furtherance of the purposes of these regulations. Without knowledge of this information, the Department may not have a complete understanding of the effectiveness of the regulations including where the regulations have failed or succeeded, and whether insurers are capable of complying with the regulations. Additionally, this information is essential to the Department's own investigations pursuant to California Insurance Code Section 1872.3.

This section is thus necessary to implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.34(c)

The Commissioner has determined that communication between the Department and insurers is necessary for the effective administration of these regulations. Better communication increases the likelihood that fraud may be prevented. Proposed Section

2698.34(c) initially provided that “timely release” of information means immediate, but no more than twenty-one calendar days after the request unless otherwise agreed to by the Fraud Division. This section of the regulations initially required that insurers release requested information immediately “but no more than twenty-one (21) calendar days after the request”. This section was initially seen as necessary to avoid such confusion by placing a limit on the word “immediate” what could potentially be viewed as a subjective requirement. Effective administration of these regulations requires an even-handed approach by which insurers may understand how to comply.

The subsection was subsequently amended to require provide that insurers release information immediately, “but no more than thirty (30) days after the request unless otherwise agreed upon by the Fraud Division.” This change was made to conform to statute. This section as amended implements, interpret and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.34(d)

The Commissioner has determined that communication between the Department and insurers is necessary for the effective administration of these regulations. Better communication increases the likelihood of preventing fraud. Proposed Section 2698.34(d) describes the manner in which communication between the insurer and the Department or other authorized governmental agency must take place in order to maximize efficiency.

This section as originally proposed required of the designation of a contact person within a SIU for purposes of communication with the Department or other authorized governmental agencies. This requirement was deleted in the March 18, 2005 revised text after the Commissioner received extensive comment from the regulated entities objecting to the expense, inefficiency and burdens imposed by such a requirement.

Section 2698.34(d) as originally proposed also stated that a single written request is sufficient to compel production of information deemed relevant by the requesting governmental agency relating to any specific insurance fraud investigation. Further, the original subsection went on to state that “the request is sufficient to compel production of the requested records at the time the request is made and at all subsequent times from all persons, agents, brokers employed by the insurer”. The Commissioner simplified this provision by eliminating the entire last phrase of the second sentence beginning with the words “at the time” and by adding the following language: “The single request is applicable throughout the duration of the investigation and is applicable to the requested records of the insurer named in the request and all persons, agents, brokers employed by and conducting business on behalf of an insurer.” This provision is necessary to clarify and delineate the insurer’s obligation to comply with document requests from governmental agencies. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.35(a)

Proposed Section 2698.35 sets forth regulations for the detection of suspected insurance fraud. Proposed Section 2698.35(a) states that an insurer's integral anti-fraud personnel are responsible for identifying suspected insurance fraud and reporting it to the SIU as part of their regular duties. This section is necessary because Section 2698.30(h) defines "integral anti-fraud personnel" as including insurer personnel who the insurer has not identified as being directly assigned to its SIU but whose duties may include the processing, investigating, or litigation pertaining to payment or denial of a claim or application. Integral anti-fraud personnel will often be in the best position to detect suspected insurance fraud. But because this type of personnel is not necessarily part of the SIU, effective communication between these types of personnel is necessary in order to effectively stop insurance fraud and thus further the purposes of these regulations. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.35(b)

Proposed Section 2698.35 sets forth regulations for the detection of suspected insurance fraud. Section 2698.35(b) requires written procedures for integral anti-fraud personnel identification, documentation, and referral of suspected insurance fraud to the SIU. The written procedures must also contain a list of red flags used to detect suspected fraud. This section is reasonably necessary in order to effectively detect fraud and for the Department's effective administration of the detection of fraud. Without this section, integral anti-fraud personnel would be without uniform guidelines on how to detect fraud and when to report it to the SIU. Such a scenario would lead to inconsistent implementation of these regulations, which would not effectively fulfill the purpose of preventing insurance fraud in California. Adequate training of anti-fraud personnel by the SIU is the best means of ensuring proper communication between these two groups.

Keeping a written record of procedure allows the Department to create a working understanding of how effective certain procedures are and ensure compliance with these regulations in a manner that furthers their purposes. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.35(c)(1)-(5)

Proposed Section 2698.35 sets forth regulations for the detection of suspected insurance fraud. Sections 2698.35(c)(1)-(5) state that the procedures for detecting suspected insurance fraud shall provide for comparison of any insurance transaction against: patterns or trends of possible fraud; red flags; events or circumstances present on a claim; behavior or history of person(s) submitting a claim or application; and other criteria that may indicate possible fraud. This language informs insurers of the type of information necessary to gather in order to create working guidelines that foster effective detection of fraud by integral anti-fraud personnel.

The list is non-exclusive because additional types of evidence may become indicative of fraud over a period of time or the importance of certain evidence might depend on the type of insurance. Without this section, an insurer's or its employees' understanding of effective procedure would be incomplete and detection and investigative procedures would grow ineffective over time. A rule that allows for evolving procedure is necessary to combat insurance fraud because fraud patterns change over time. These subsections implement, interpret, and make specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.36(a)(1)

California Insurance Code Section 1875.20 states that the purpose of the SIU is to “investigate possible fraudulent claims by insureds or by persons making claims for services or repairs against policies held by insureds,” but does not provide guidelines for how the SIU should perform this investigation. Proposed Section 2698.36 establishes what an investigation of possible suspected insurance fraud must include. Section 2698.36(a)(1) requires a thorough analysis of a claim file, application, or insurance transaction. These documents are the source of the most information from the insured and thus could be the greatest indicator of misrepresentation or omission of a relevant fact. These documents can also be compared against any of the patterns of evidence suggesting insurance fraud listed in Section 2698.35(c). The absence of these documents would significantly increase the difficulty of fraud investigation. By requiring this procedure, the regulations further the legislative intent of stopping insurance fraud in California. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.36(a)(2)

California Insurance Code Section 1875.20 states that the purpose of the SIU is to “investigate possible fraudulent claims by insureds or by persons making claims for services or repairs against policies held by insureds,” but does not provide guidelines for how the SIU should perform this investigation. Proposed Section 2698.36 establishes what an investigation of possible suspected insurance fraud must include. Section 2698.36(a)(2) requires identification and interviews of potential witnesses who may provide information on the accuracy of the claim or application. This procedure allows for scrutiny of insured claims by allowing the examination of persons with knowledge of the claims who can provide evidence of actual fraud. Without this essential step in the investigation process an investigation would be limited to little more than the claim of the insured himself. An effective investigation of suspected insurance fraud requires greater scrutiny than relying on the insured's claim. By requiring this procedure, the regulations further the legislative intent of stopping insurance fraud in California. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.36(a)(3)

California Insurance Code Section 1875.20 states that the purpose of the SIU is to “investigate possible fraudulent claims by insureds or by persons making claims for services or repairs against policies held by insureds,” but does not provide guidelines for how the SIU should perform this investigation. Proposed Section 2698.36 establishes what an investigation of possible suspected insurance fraud must include. Section 2698.36(a)(3) requires the utilization of industry-recognized databases. Such databases provide another source of information by which to compare the claims of the insured. The greater the amount of relevant information the insurer has to compare the claims of the insured with the more likely the insurer will be able to prevent actual fraud. By requiring this procedure, the regulations further the legislative intent of stopping insurance fraud in California. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.36(a)(4)

California Insurance Code Section 1875.20 states that the purpose of the SIU is to “investigate possible fraudulent claims by insureds or by persons making claims for services or repairs against policies held by insureds,” but does not provide guidelines for how the SIU should perform this investigation. Proposed Section 2698.36 establishes what an investigation of possible suspected insurance fraud must include. Section 2698.36(a)(4) requires the preservation of documents and other evidence. The preservation of evidence allows for effective investigation by creating a record of what is known and allowing a comparison of that information to new information. The preservation of evidence also allows for comparison of suspected insurance fraud in one claim to suspected fraud in a later claim. The Department may also need this record for its own investigations. By requiring this procedure, the regulations further the legislative intent of stopping insurance fraud in California. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.36(a)(5)

California Insurance Code Section 1875.20 states that the purpose of the SIU is to “investigate possible fraudulent claims by insureds or by persons making claims for services or repairs against policies held by insureds,” but does not provide guidelines for how the SIU should perform this investigation. Proposed Section 2698.36 establishes what an investigation of possible suspected insurance fraud must include. Section 2698.36(a)(5) requires the writing of a concise and complete summary of the investigation including conclusions and their basis of findings. This section is necessary to further the intent of creating an evolving understanding of what indicates suspected and actual fraud and the efficacy of the regulations. The preservation of summaries and conclusions helps create a pattern by which future investigations of suspected fraud will benefit. All investigations, including the Department’s, may benefit by an insurer’s preservation of summaries and conclusions. By requiring this procedure, the regulations further the legislative intent of stopping insurance fraud in California. This subsection

implements, interprets, and makes specific California Insurance Code Section 1875.20-24. This section was amended so that the last word of the subsection is “findings” rather than “conclusions”. This word choice specifies that the regulations require the basis for findings leading up to the conclusion rather than just the basis for the ultimate conclusion. This information will help the Department in its own investigation of fraud by not requiring the Department to engage in fact-finding that others have already completed.

Proposed Section 2698.37(a)

Proposed Section 2698.37(a) requires the referral of suspected insurance fraud to the Fraud Division, and as required, district attorneys. This section is necessary as it clearly delineates the obligation of the insurer to refer suspected insurance fraud to the appropriate agency. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.37(b)

The Commissioner has determined that effective implementation of California Insurance Code Sections 1875.20-23 and other parts of the IFPA require the submittal of referrals in any transaction where there is a reasonable belief of past or current fraud. Proposed Section 2698.37(b) states this purpose. This section requires the referral of suspected insurance fraud. This requirement improves communication by not allowing a party who reasonably believes there is fraud to wait for a request for this information. This section is necessary to clarify the standard for when referrals are necessary. Because the proposed section requires a “reasonable belief,” the insurer’s referral of suspected insurance fraud should be based on objective facts and rational inferences based on those facts. This wording matches that of California Insurance Code Section 1877.3, which sets forth the duty to report a reasonable belief that fraud has been committed.

The referral of suspected insurance fraud is an important part of the Department’s implementation of the IFPA. But the Department can not effectively administer these regulations if inundated with unnecessary referrals. This section thus limits referral to those where there is a reasonable belief of fraud. This limitation allows for the proper investigation of referrals. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.37(c)

Because of the emergency nature of insurance fraud in California, the Commissioner has determined that effective implementation of California Insurance Code Sections 1875.20-24 and other parts of the IFPA require the referral of suspected insurance fraud to the Fraud Division, and as required, district attorneys. Proposed Section 2698.37(c) sets the time period in which insurers must refer suspected insurance fraud to the Fraud Division. This section is necessary because it provides needed specificity for the insurer by indicating the period in which they must refer suspected insurance fraud. Proposed

Section 2698.37(c) states that the referral shall be made within the period specified by statute. The IFPA provides different time limits for referrals at Sections 1872.4, 1874.2, and 1877.3. The time limits vary greatly depending on the basis for referral. This section refers to the Insurance Code because the time period for the communications has already been determined by statute. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.37(d)

Proposed Section 2698.37 (d) was adopted by the Commissioner in the March 18, 2005 Revised Text . This newly adopted subsection clarifies that the requirements imposed on insurers regarding the referral of suspected insurance fraud by section 2698.37 do not affect any immunity granted to insurers by California Insurance Code Section 1872.5 or other similar codes. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.37(e)

Proposed Section 2698.37 (d) was adopted by the Insurance Commissioner in the March 18, 2005 revised text. This newly adopted subsection clarifies that the requirements imposed on insurers regarding the referral of suspected insurance fraud by section 2698.37 do not diminish the confidentiality requirements imposed on insurers and set forth in the Insurance Fraud Prevention Act. This subsection assists insurers in understanding their obligations so that compliance can be achieved. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.38(a)(1)-(2)

Proposed Section 2698.38 provides guidelines for insurers on what to include in a referral of suspected insurance fraud to the Fraud Division. Section 2698.38(a) requires the inclusion of the type of fraud and the type of referral. These subsections are necessary to inform insurers that the Department requires this information for an effective determination of whether actual fraud exists. This specific information narrows the investigative scope for the Department so that the referral can be properly filed and investigated correctly. Needless time would be spent categorizing the referral without this information. These subsections implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.38(b)(1)-(6)

Proposed Section 2698.38 provides guidelines for insurers on what to include in a referral of suspected insurance fraud to the Fraud Division. Section 2698.38(b) requires the inclusion of reporting party information. These subsections are necessary to inform insurers that the Department requires this information for an effective determination of whether actual fraud exists. This specific information is central to a determination of

fraud because it allows the Department to identify the reporting party and contact the reporting party for investigative purposes. The absence of this information would severely inhibit the Department's investigation as well as the prevention of insurance fraud in the State of California. These subsections implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.38(c)(1)-(4)

Proposed Section 2698.38 provides guidelines for insurers on what to include in a referral of suspected insurance fraud to the Fraud Division. Section 2698.38(c) requires the inclusion of alleged victim information. These subsections are necessary to inform insurers that the Department requires this information for an effective determination of whether actual fraud exists.

This specific information is central to a determination of fraud because it allows the Department to identify and contact the alleged victim for investigative purposes. The absence of this information would severely inhibit the Department's investigation as well as the prevention of insurance fraud in California. These subsections implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.38(d)(1)-(10)

Proposed Section 2698.38 provides guidelines for insurers on what to include in a referral of suspected insurance fraud to the Fraud Division. Section 2698.38(d) requires the inclusion of insurance policy or claim information, as appropriate. These subsections are necessary to inform insurers that the Department requires this information for an effective determination of whether actual fraud exists.

This specific information is central to a determination of fraud because it provides the Department with an understanding of why a particular claim is suspected to be fraudulent. This crucial evidentiary record provides the Department with the appropriate leads to investigate in its determination of actual fraud. The absence of this information would severely inhibit the Department's investigation as well as the prevention of insurance fraud in the State of California. These subsections implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.38(e)(1)-(4)

Proposed Section 2698.38 provides guidelines for insurers on what to include in a referral of suspected insurance fraud to the Fraud Division. Section 2698.38(e) requires the inclusion of other agency referral information, as appropriate. These subsections are necessary to inform insurers that the Department requires this information for an effective determination of whether actual fraud exists.

This specific information is important to an investigation of fraud because it provides the Department names of other persons or agencies that may be in the process of independent

investigations. Inter-agency cooperation will lead to a more thorough and efficient investigation but is only possible if the Department is made aware of these additional referrals. The absence of this information would severely inhibit the Department's investigation as well as the prevention of insurance fraud in the State of California. These subsections implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.38(f)(1)-(4)

Proposed Section 2698.38 provides guidelines for insurers on what to include in a referral of suspected insurance fraud to the Fraud Division. Section 2698.38(f) requires the inclusion of other referral contact information, as appropriate. These subsections are necessary to inform insurers that the Department requires this information for an effective determination of whether actual fraud exists.

This specific information is important to an investigation of fraud because it provides the Department contact information for other persons who may be in the process of independent investigations. Inter-agency cooperation will lead to a more thorough and efficient investigation but is only possible if the Department is made aware of the contact information for these referrals. Otherwise, determining appropriate contact information will lead to needless delay and severely inhibit the Department's investigation as well as the prevention of insurance fraud in the State of California. These subsections implement, interpret, and make specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.38(g)(1)-(13)

Proposed Section 2698.38 provides guidelines for insurers on what to include in a referral of suspected insurance fraud to the Fraud Division. Section 2698.38(g) requires the inclusion of information for each party associated with the referral. These subsections are necessary to inform insurers that the Department requires this information for an effective determination of whether actual fraud exists.

This specific information is important to an investigation of fraud because detailed information relating to contact information and identity of parties involved is necessary for efficient investigation of the parties and the central claim. For example, this data would be compared to industry-recognized database records. The absence of this information would severely inhibit the Department's investigation as well as the prevention of insurance fraud in the State of California. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39

This section delineates the training that is required of insurer's employees. As set forth in the proposed subsection training consists of three levels: (1) new-hire training; (2) integral anti-fraud training and; (3) SIU training. This change in structure from the emergency regulations was necessary to clearly inform insurers of the appropriate

manner in which to train employees based upon their different responsibilities pursuant to these regulations. This section provides several lists on how to create an effective training program.

Proposed Section 2698.39(a)

Section 2698.39(a) requires that the insurer establishes and maintains an ongoing anti-fraud training program that will develop the fraud-awareness skills of the integral anti-fraud personnel. The emergency regulations required the SIU to perform this function. Although the SIU still has an obligation to create written procedures for the detection and investigation of suspected insurance fraud, an insurer is in the best position to train integral anti-fraud personnel because they are likely to be working directly with the insurer while the SIU may be contractual. Thus, the relationship between an insurers and ant-fraud personnel is likely to better foster an effective training program than the relationship between the SIU and other insurer employees. The crucial relationship between the SIU and anti-fraud personnel will be maintained through the SIU's creation of written procedures pursuant to these regulations.

This section is necessary to further the purpose of the regulations in preventing insurance fraud. Continuous training raises fraud awareness and will allow integral anti-fraud personnel to adapt to changing patterns in insurance fraud. Without this requirement, anti-fraud personnel will become ineffective in the prevention of fraud because fraud is an evolving malignancy rather than a static one. Moreover, the pursuit of preventing any fraud is in furtherance of these regulations and the IFPA. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-23.

Proposed Section 2698.39(b)

Section 2698.39(b) requires that the insurer designate an SIU staff person to be responsible for coordinating the ongoing anti-fraud training program. This section is necessary for the creation of an effective training program. The allocation of coordination duties to a single SIU staff person prevents confusion as to who is responsible for coordinating the training program. This section implements, interprets, and makes specific California Insurance Code Section 1875.20-23.

Proposed Section 2698.39(c)(1)(A-E)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what "training" entails, which resulted in inadequate staff. Section 2698.39(c) sets forth what the subject matter for the three different training levels. Section 2698.39(c)(1)(A)(E) sets forth the requirements for orientation of all new employees that must be completed within 90 days. These requirements cover the basic overview of fraud detection and what the SIU is and the way it functions. This type of training is reasonably necessary for all employees because they are likely to deal with information that should be forwarded to the SIU or integral

anti-fraud personnel; the purpose of this subsection is to ensure that all employees are aware of what to do with information that could relate to insurance fraud. Subsection 2698.31 (c)(1) was amended as the result of public comment to change the language of the subsection from “training” to “orientation” and the word “instruction” to “information”. These changes were made to ensure that the training of all new employees contains the necessary information that will enable new employees to recognize suspected fraud and to know where to direct any information they obtain regarding such fraud. Additionally, the Insurance Commissioner has added 2698.39(c)(1)(E) that requires that all new employees receive a list of SIU contact telephone numbers. This section is necessary for effective communication between all insurer employees and the SIU. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(2)(A)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what constitutes “training”. Section 2698.39(c)(2) sets forth what the subject matter for integral anti-fraud personnel in-service training shall be. Section 2698.39(c)(2)(A) requires review of the function and purpose of the SIU. This section is reasonably necessary to ensure that the anti-fraud personnel are aware of what the SIU’s purpose is so that the personnel can effectively interact with the SIU. Because the SIU will be independent from other insurer employees, effective communication between them is necessary. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(2)(B)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what constitutes “training”, which resulted in inadequate staff. Section 2698.39(c)(2) sets forth what the subject matter for integral anti-fraud personnel in-service training. Part of the responsibilities of integral anti-fraud personnel will be to direct suspected fraud claims to the SIU. Section 2698.39(c)(2)(B) requires the introduction or review of the written procedures established by the SIU. This section is necessary to inform the anti-fraud personnel how to effectively perform their job capacity with regards to cooperation with the SIU. The absence of this section would result in miscommunication and loss of information between the SIU and anti-fraud personnel. Integral anti-fraud personnel must be aware of SIU procedure so that insurance fraud may be detected and deterred. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(2)(C)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. Section 2698.39(c)(2) sets

forth what the subject matter for integral anti-fraud personnel in-service training shall be. Section 2698.39(c)(2)(C) requires the identification of red flags and red flag events. This section is necessary because recognition of red flags is central to the prevention of insurance fraud. Red flags are a common element among multiple fraud cases, the recognition of which makes the investigation of fraud more efficient. Without this section, anti-fraud personnel's knowledge of red flags would be inadequate and thus could lead to inconsistent reporting to the SIU. The uniform application of these regulations is necessary in order to limit as much fraud as possible. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(2)(D)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. Section 2698.39(c)(2) sets forth what the subject matter for integral anti-fraud personnel in-service training shall be. Section 2698.39(c)(2)(D) requires training on any changes to current procedures. This section is necessary because as fraud patterns change, procedures for detecting and documenting fraud must also change in order to be effective. Moreover, integral anti-fraud personnel must be uniformly trained on these procedures in order to avoid miscommunication that would otherwise result between the SIU and the anti-fraud personnel. This miscommunication will occur if not all insurer employees are following the same procedures. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(2)(e)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what "training" entails, which resulted in inadequate staff. Section 2698.39(c)(2) sets forth what the subject matter for integral anti-fraud personnel in-service training shall be. Section 2698.39(c)(2)(E) requires training on Fraud Division insurance reporting requirements. This section is necessary to ensure compliance with the reporting requirements within these regulations. Without this section, anti-fraud personnel might not understand the reporting provisions, including the time period in which referrals must be made. Compliance with these regulations is necessary to ensure the most effective fraud prevention scheme. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(2)(F)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in providing guidance to insurers on what "training" entails, which

resulted in inadequate staff. Section 2698.39(c)(2) sets forth what the subject matter for integral anti-fraud personnel in-service training shall be. Section 2698.39(c)(2)(F) requires training on existing and new, emerging insurance fraud trends. This section is necessary for anti-fraud personnel to deter insurance fraud despite the fact that the patterns it creates may change over time. Without this requirement, anti-fraud personnel may become ineffective due to lack of knowledge. Familiarity with the present state of insurance fraud including its trends is an essential part of preventing it because insurance fraud is an evolving problem rather than a static one. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(3)(A)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what constitutes “training.” Section 2698.39(c)(3) sets forth what the subject matter for continuing SIU personnel training shall be. Section 2698.39(c)(3)(A) requires training on investigate techniques. This section is necessary to ensure the effectiveness of SIU investigations. Without continuing training on investigative techniques, SIU personnel may become ineffective over time or unfamiliar with current trends. Moreover, a proactive approach to investigative techniques is more effective in the prevention of new patterns of fraud. The pursuit of no insurance fraud is in furtherance of the purposes of these regulations and the IFPA but may only be accomplished with well-trained staff. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(3)(B)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what “training” entails, which resulted in inadequate staff. Section 2698.39(c)(3) sets forth what the subject matter for continuing SIU personnel shall be. Section 2698.39(c)(3)(B) requires training on communication with the Fraud Division and authorized governmental agencies. This section is necessary for insurer compliance with these regulations. Without this requirement, SIU personnel might not understand the requirements for communication and referrals, including time periods in which communications and referrals must be made. The Department’s effective implementation of California Insurance Code Section 1875.20-24 depends on the ability of insurers to comply with the provisions of these regulations relating to communication. The Department’s own investigations and awareness of fraud in this State depend on this communication. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(3)(C)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations

were inadequate in giving guidance to insurers on what “training” entails, which resulted in inadequate staff. Section 2698.39(c)(3) sets forth what the subject matter for continuing SIU personnel shall be. Section 2698.39(c)(3)(C) requires training on fraud indicators. This section is necessary for the effectiveness of the SIU. If SIU personnel are unfamiliar with fraud indicators, their reports on fraud will be inconsistent, their investigations will be inefficient, and much fraud will go undetected. The Commissioner has determined that the immediate and uniform implementation of these regulations is necessary to combat insurance fraud. This implementation can only occur with a SIU that is knowledgeable of fraud indicators. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(3)(D)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what “training” entails, which resulted in inadequate staff. Section 2698.39(c)(3) sets forth what the subject matter for continuing SIU personnel shall be. Section 2698.39(c)(3)(D) requires training on emerging fraud trends. This section is necessary for SIU personnel to detect and deter insurance fraud despite the fact that the patterns it creates may change over time. Without this requirement, anti-fraud personnel may become ineffective due to lack of knowledge. Familiarity with the present state of insurance fraud including its trends is an essential part of preventing it because insurance fraud is an evolving problem rather than a static one. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(c)(3)(E)

Proposed Section 2698.39 sets forth the requirements for anti-fraud training for SIU and integral anti-fraud personnel recognition of insurance fraud. The emergency regulations were inadequate in giving guidance to insurers on what constitutes “training,” which resulted in inadequately trained staff. Section 2698.39(c)(3) sets forth what the subject matter for continuing SIU personnel shall be. Section 2698.39(c)(3)(E) requires training on legal and related issues. This section is necessary for SIU personnel to have an understanding of the legal context in which they are performing their job duties. Rather than existing in a vacuum, there are legal implications for many of SIU job decisions and functions and for the information that SIU personnel receive. Insurers are in the best position to determine exactly what legal issues SIU personnel need to know to effectively perform their function in furtherance of the purposes of these regulations and the IFPA because what constitutes a relevant legal issue depends on the context of the function being performed. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.39(d)

Section 2698.39(d) sets forth requirements for the preservation of records concerning anti-fraud training. This section is reasonably necessary for the Department to oversee training programs and to ensure that personnel receive the appropriate training. The effectiveness of certain procedures can only be recognized and measured if the insurer retains the required training material. Preservation of these records is also necessary to determine compliance with these regulations. Without this section there would be little insurer accountability for training, which could inhibit the prevention of insurance fraud in the State of California. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(a)

Proposed Section 2698.40(a) requires insurers to report annually to the Department and sets the time period for this process. This section is reasonably necessary to fight the exorbitant costs of insurance fraud in the State of California. Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate and insurance fraud is an epidemic in the State of California. The Department must have an annual report that includes information relevant to these regulations in order to ensure compliance and the detection and deterrence of fraud. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(1)-(2)

Proposed Section 2698.40(b)(1) requires the annual report to include the names, titles and contact information of the insurer's SIU personnel or the name of the organization and organizational contacts with whom the insurer has contracted for the maintenance of the SIU or any function thereof. Previous insurer reporting proved inadequate for the Department to have a complete understanding of the insurance industry's compliance with the regulations and the effect the regulations had on insurance fraud. This section is reasonably necessary for the Department's verification of a dedicated SIU staff. The inclusion of contact information also allows the Department to contact SIU staff with questions during their own investigations. The communication essential to effective implementation of the regulations would prove difficult if the Department did not have this information. This subsection implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.40(b)(3)

Proposed Section 2698.40(b)(3) requires insurers to include in their annual report the names of personnel whose duties include communication with the Fraud Division on matters relating to suspected insurance fraud. Previous insurer reporting proved inadequate for the Department to have a complete understanding of the insurance industry's compliance with the regulations and the effect the regulations had on insurance fraud. This section is reasonably necessary for the Department to have notice of the

names of an insurer's staff that they should be dealing with. The absence of this information will lead to needless delay in communication or lead to miscommunication. This subsection implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.40(b)(4)

Proposed Section 2698.40(b)(4) requires insurers to include in their annual report a description of methods and written procedures for the detection, investigation and reporting of insurance fraud. This section is necessary for the Department's effective administration of these regulations. Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of the insurer's methods and written procedures. This information not only shows compliance but also educates the Department as to which methods of detection and investigation are effective in preventing insurance fraud. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(5)

Proposed Section 2698.40(b)(5) requires insurers to include in their annual report a description of the insurer's plan for initial and on-going fraud education and training for integral anti-fraud personnel. This section is necessary for the Department's effective administration of these regulations. Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of the insurer's plan for training. This information not only shows compliance but also educates the Department as to which methods of detection and investigation are effective in preventing insurance fraud. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(6)

Proposed Section 2698.40(b)(6) requires insurers to include in their annual report a written description or chart outlining the organizational arrangement of the insurer's anti-fraud personnel. This section is necessary for the Department's effective administration of these regulations. Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of the arrangement of insurers' anti-fraud personnel. This information not only shows compliance with these regulations but also educates the Department as to effective arrangements of personnel. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(7)

Proposed Section 2698.40(b)(7) requires insurers to include in their annual report a description of how the SIU is adequately staffed to meet the requirement herein and the expertise of the staff. Previous insurer reporting proved inadequate for the Department to have a complete understanding of the insurance industry's compliance with the regulations and the effect the regulations had on insurance fraud. This section is necessary for the Department's effective administration of these regulations. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of how the insurer's SIU is adequately staffed. Inadequate staffing will lead to inconsistent implementation of these regulations and thus will not combat fraud sufficiently. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(8)

Proposed Section 2698.40(b)(8) requires insurers to include in their annual reports the number of claims processed by the insurer and the number of claims referred to the SIU, for each reported company, for the past calendar year. Previous insurer reporting proved inadequate for the Department to have a complete understanding of the insurance industry's compliance with the regulations and the effect the regulations had on insurance fraud. This section is necessary for the Department's effective administration of these regulations. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of the amount of activity to which an insurer's SIU is subject. This information relates to whether an insurer's staff is adequate. A large amount of fraud activity suggests that a larger SIU is necessary to effectively comply with these regulations. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(9)

Proposed Section 2698.40(b)(9) requires insurers to include in their annual report the number of suspected insurance fraud reported to the Department and to district attorney offices, for each reported company, for the past calendar year. Previous insurer reporting proved inadequate for the Department to have a complete understanding of the insurance industry's compliance with the regulations and the effect the regulations had on insurance fraud. This section is necessary for the Department's effective administration of these regulations. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of the number of reports the insurer has made. This information relates to whether an insurer's staff is adequate. A large amount of fraud activity suggests that a larger SIU staff is necessary to effectively comply with these regulations. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(10)

Proposed Section 2698.40(b)(10) requires insurers to include in their annual report a description of any significant, anticipated changes to the insurer's operations. This section is necessary for the Department's effective administration of these regulations. Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of any such changes in the insurer's operations. Otherwise, an insurer might implement a plan known to the Department to be ineffective or in noncompliance with these regulations. The Commissioner has determined that uniform application of these regulations is necessary to combat fraud. Lack of notification to the Department of such changes will lead to less detection and deterrence of fraud. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(11)

Proposed Section 2698.40(b)(11) requires insurers who enter into contract for compliance with these regulations to provide a copy of that contract in their annual report. This language is slightly different from that of the emergency regulations in that the words "these regulations" replace the words "CIC Section 1875.20 et seq." This change reflects the reality that such contracts will be subject to the specific regulations that implement the insurance code. This change avoids the mistaken belief that the regulations for a contracted SIU do not apply under this section.

This section is necessary for the Department's effective administration of these regulations. Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of provisions of a contract entered into by an insurer for the purposes of compliance with these regulations. The insurer shall decide the appropriate manner of monitoring the contract because it is a contextual decision based upon the terms of the parties' contract. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(b)(12)

Proposed Section 2698.40(b)(12) requires that insurers include in their annual report the number and type of civil actions initiated by each reported company alleging acts of insurance fraud during the preceding calendar year. The language of this section changes the emergency regulations by replacing the word "for" with the words "initiated by." The word "for" was ambiguous because it was not clear what type of action was intended to be referenced. The new language clarifies that the action must be brought by the insurance company.

Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. This section is necessary for the Department's effective administration of these regulations. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of the number of civil actions brought by the company alleging insurance fraud. The number of civil actions directly relates to how well the insurer is detecting and deterring fraud. In conjunction with other evidence, this information could suggest that fraud is slowing or decreasing or how well the insurer is detecting fraud. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(c)

Proposed Section 2698.40(c) requires the signing and attestation of the report by an officer of the holder of or applicant for the Certificate of Authority. This section is necessary for the Department's effective administration of these regulations. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have knowledge of the report's accuracy. This certification will specifically verify the accuracy of the report. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

The words "pursuant to the laws of the state of California" have been added after the words "penalty of perjury" in the emergency regulations. This change specifies that perjury is a crime with its own code section, independent of the Insurance Code, which will define its meaning and implementation.

This section also changes the emergency regulations by replacing the words "required by CIC Section 1875.20 et seq." with the words "described in this report." This change avoids the unintended reading that this section requests verification of the signor's knowledge of the code while in fact the intended meaning requires the signor's knowledge of the insurer's SIU. The purpose of this section is to ensure that an insurer's SIU is operating correctly and this purpose can only be verified by this section's intended meaning as clarified by the proposed change to the emergency regulations.

Proposed Section 2698.40(d)

Proposed Section 2698.40(d) requires insurers to retain a copy of the annual report for review. The Commissioner has amended this subsection to contain additional language. This section is necessary for the Department's effective administration of these regulations. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must have a record of past reports. The preservation of these records reveals patterns of insurance fraud and allows for a determination of what detection and investigation methods are most effective. Additionally, it should be noted, the Commissioner has added the words "during the examination as conducted pursuant to section 2698.41 of these regulations or as otherwise requested by the Department" to the end of section 2698.40(d).

It is less burdensome for individual insurers to retain personal reports than for the Department to retain all reports for all insurers in the State of California. Without this section it would be difficult to ensure the preservation of necessary records. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.40(e)

Proposed Section 2698.40(e) states that the names of the insurer's personnel who will communicate with the Fraud Division shall not be made part of the public record and shall be released only according to California Insurance Code Section 1873.1. Section 1873.1 allows for disclosure of this information only when required in connection with a criminal or civil proceeding. This section adopts the standard in the Insurance Code because it is an appropriate balance between consumer interests of public disclosure and the privacy interests that will promote candor between the Department and insurers. Encouraging open communication between the Department and insurers can only help to further the goal of preventing insurance fraud. This subsection implements, interprets, and makes specific California Insurance Code Section 1875.20-24.

Proposed Section 2698.41(a)

Proposed Section 2698.41(a) permits the commissioner to conduct an examination of an insurer's SIU. California Insurance Code Section 730(a) permits the commissioner to examine an insurer whenever he or she deems necessary. This section is reasonably necessary to determine that insurers are complying with these regulations. Although an examination will not necessarily occur, the ability of the commissioner to examine the SIU's operations makes the SIU accountable and encourages compliance with these regulations and thus furthers the goal of preventing insurance fraud. Previous regulatory attempts at deterring and detecting insurance fraud proved inadequate. In order to ensure that the proposed regulations are being followed and that they are deterring and detecting fraud the Department must be permitted to examine an insurer's SIU to determine compliance. This subsection implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.41(b)

Proposed Section 2698.41(b) provides that an insurer will be given a written report of the examination including identification of violations of these regulations and the required corrective actions. This section is reasonably necessary to improve compliance with these regulations and thus further the goal of preventing insurance fraud. The pursuit of allowing zero insurance fraud in the State of California is in furtherance of the purposes of these regulations and the IFPA. Without this section, insurers might not know how to improve their operations and progress would prove difficult. This subsection implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.41(c)(1)

Proposed Section 2698.41(c)(1) provides that an insurer will have thirty days to reply to a report identifying violations of these regulations with a plan demonstrating how the insurer will achieve compliance. This section is reasonably necessary to improve compliance with these regulations and thus further the goal of preventing insurance fraud. The pursuit of allowing zero insurance fraud in the State of California is in furtherance of the purposes of these regulations and the IFPA. Without this section, insurers might not quickly change their operations to comply with the regulations. Immediate enhancement of the insurer's ability to rapidly detect and deter fraud is essential because of the emergency state of insurance fraud in the State of California. Imposing fines for violations without requiring a plan for compliance would not further this purpose because insurers would have less incentive to quickly comply. Nor would insurers necessarily know how to comply. This subsection implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.41(c)(2)(A)

Proposed Section 2698.41(c)(2)(A) allows any insurer submitting a corrective plan pursuant to Section 2698.41(c) to include any written material that may rebut any matters contained in the examination report. This section was not part of the emergency regulations but addresses the concern of noncompliance. This section is reasonably necessary to allow review of findings made in the examination. Mistakes are possible during an examination and this section provides a procedure for insurers to bring those mistakes to the Department's attention. Without this section, insurers would have no opportunity for Department review of examination findings. On September 20, 2004 the California Legislature enacted California Insurance Code Section 1875.24; this statutory section became effective January 1, 2005. This statute established monetary penalties for violations of the proposed regulations in specified amounts based on whether the violation was willful or inadvertent and specifically granted the Insurance Commissioner the discretion to determine what constitutes an act for the purposes of imposing penalties. Further, this statute mandated that the Commissioner adopt regulations to implement California Insurance Code Section 1875.24 in accordance with the rulemaking provisions of the Administrative Procedures Act. Accordingly, because the originally promulgated Section 2698.42(a) addressed the issue of penalties for violations of the regulations prior to the enactment of California Insurance Code Section 1875.24, the newly adopted Section 2698.42(a) replaces the repealed subsection. The newly adopted Section 2698.42(a) clearly delineates the monetary penalties to be imposed for violation of the regulations under the new statute

This subsection has been deleted from these regulations. As set forth in the Updated Informative Digest the newly enacted statute California Insurance Code Section 1875.24 is now the controlling authority with respect to the imposition of penalties for violations of these regulations. In particular California Insurance Code Section 1875.24 (a) sets forth the various alternatives an insurer may pursue when notified that they are not in compliance with the regulations. Section 2698.41(c)(3) is therefore unnecessary.

Proposed Section 2698.42(a)

On September 20, 2004 the California Legislature enacted California Insurance Code Section 1875.24; this statutory section became effective January 1, 2005. This statute established monetary penalties for violations of the proposed regulations in specified amounts based on whether the violation was willful or inadvertent and specifically granted the Insurance Commissioner the discretion to determine what constitutes an act for the purposes of imposing penalties. Further, this statute mandated that the Commissioner adopt regulations to implement California Insurance Code Section 1875.24 in accordance with the rulemaking provisions of the Administrative Procedures Act. Accordingly, because the originally promulgated Section 2698.42(a) addressed the issue of penalties for violations of the regulations prior to the enactment of California Insurance Code Section 1875.24, the newly adopted Section 2698.42(a) replaces the repealed subsection. The newly adopted Section 2698.42(a) clearly delineates the monetary penalties to be imposed for violation of the regulations under the new statute. This subsection 2698.42 (a) clarifies that the Commissioner shall impose a monetary penalty not to exceed \$ 5,000 for each act of non-compliance. The subsection goes on to further provide that where the Commissioner has determined the act to be willful, the Commissioner shall impose a penalty of up to \$10,000 per willful act. The subsection goes on to provide that the Commissioner shall consider the factors set forth at California Code of Regulations Title 10, Chapter 5, Subchapter 3, Sections 2591.3 (a-f) and determine if they are applicable to the insurer's conduct. These factors describe factual situations where the insurer's conduct may be considered willful. If the Commissioner determines that the factors cited above are applicable, the Commissioner may reduce the amount of the penalty. This subsection implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.42(b)

On September 20, 2004 the California Legislature enacted California Insurance Code Section 1875.24; this statutory section became effective January 1, 2005. This statute established monetary penalties for violations of the proposed regulations in specified amounts based on whether the violation was willful or inadvertent and specifically granted the Insurance Commissioner the discretion to determine what constitutes an act for the purposes of imposing penalties. Further, this statute mandated that the Commissioner adopt regulations to implement California Insurance Code Section 1875.24 in accordance with the rulemaking provisions of the Administrative Procedures Act. Accordingly, because the originally promulgated Section 2698.42(b) addressed the issue of penalties for violations of the regulations prior to the enactment of California

Insurance Code Section 1875.24, the newly adopted Section 2698.42(b) replaces the prior subsection.2698.42 (b).

The newly adopted Section 2698.42(b) clearly delineates the manner in which the Commissioner shall determine the amount of the penalty for inadvertent acts under the new statute. Accordingly, Section 2698.42(b) provides that the Insurance Commissioner shall impose a penalty of up to \$5,000 per inadvertent act except that if the Commissioner finds the inadvertent acts to be solely relative to the maintenance and operation of the special investigative unit, the Commissioner may consider such acts to be a single act for purposes of imposition of the penalty. This subsection implements, interprets, and makes specific California Insurance Code Sections 1875.20-24.

Proposed Section 2698.43 (a) and(b)

On September 20, 2004 the California Legislature enacted California Insurance Code Section 1875.24; this statutory section became effective January 1, 2005. This statute established monetary penalties for violations of the proposed regulations in specified amounts based on whether the violation was willful or inadvertent and specifically granted the Insurance Commissioner the discretion to determine what constitutes an act for the purposes of imposing penalties.

California Insurance Code Section 1875.24(c) enumerates the options available to an insurer that has been served with a notice of non-compliance regarding these regulations. California Insurance Code Section 1875.24.(c)(2) specifically authorizes an insurer to request a hearing., notice of which must be given at least 10 days before the requested date. The statute, however, does not delineate any additional procedural requirements for the hearing. Accordingly, the Commissioner has adopted Sections 2698.43 (a) and (b) to further delineate and clarify the nature of any hearing held. pursuant to 1875.24(c)(2). Sections 2698.43 (a) clarifies that California Government Code Section 11425.10 (a) governs any hearing held pursuant to California Insurance Code Section 1875.24. This is merely a restatement of the applicable law and is intended to assist regulated entities in understanding their obligations.

Section 2698.43(b) provides that the Commissioner shall give 30 days written notice of any hearing held pursuant to these regulations. The Commissioner has specifically granted insurers additional time beyond the minimum prescribed by 1875.24(d), in order to ensure that the insurer has a sufficient time period within which to comply.

Further, this statute mandated that the Commissioner adopt regulations to implement California Insurance Code Section 1875.24 in accordance with the rulemaking provisions of the Administrative Procedures Act.

IDENTIFICATION OF STUDIES AND REPORTS

The Commissioner has not relied on any studies or reports in the promulgation of these regulations.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of the proposed regulations would not mandate the use of specific technologies or equipment.

CONSIDERATION OF ALTERNATIVES

The Commissioner has not identified alternatives to any of the sections or subdivisions thereof which would lessen any adverse impact on small businesses yet still achieve the desired regulatory objective.

IMPACT ON SMALL BUSINESS

The Commissioner has determined that small businesses may incur additional expenses as a result of these regulations. These expenses may include: training costs; staffing or contracting costs for the purposes of the creation of an SIU; and the value of insurer's time spent communicating with the SIU and the Department.